

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Soto Analyst: Kristina E. North Bill Number: SB 1099

Related Bills: None Telephone: 845-6978 Introduced Date: February 23, 2001

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Business Expense Deduction/Disallow Prescription Drug Advertising

## SUMMARY

This bill would prohibit corporate manufacturers from deducting the cost of advertising prescription drugs.

## PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to discourage unnecessary requests for and use of prescription drugs by the public.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would apply to taxable years beginning on or after January 1, 2001.

## POSITION

Pending.

### Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the concerns addressed in this analysis.

## ANALYSIS

### FEDERAL/STATE LAW

**Current federal and state laws** allow businesses to deduct their ordinary and necessary expenses, including advertising and promotional costs. These costs can be deducted even though the benefit they generate may extend past the taxable year in which the cost was paid or incurred.

### THIS BILL

**This bill** would disallow a deduction for costs paid or incurred by a corporate manufacturer of prescription drugs to advertise the sale, use, or other consumption of prescription drugs.

Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

05/25/01

**This bill** would define "advertise" to include the use of a newspaper, magazine, or any other method used now or in the future to sell or promote prescription drugs.

#### IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would not significantly impact the department.

#### **OTHER STATES' INFORMATION**

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable disallowance of a deduction. These states were reviewed because of their similarities to California income tax laws.

#### **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

#### **ECONOMIC IMPACT**

##### Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in revenue gains under the corporate tax law as follows.

<b>Estimated Revenue Impact of SB 1099</b> As Introduced 2/23/01 [\$ In Millions]		
2001/2002	2002/2003	2003/2004
\$20	\$26	\$27

##### Tax Revenue Discussion

The revenue impact of this bill would be determined by the amount of advertising expenses paid or incurred by manufacturers of prescription drugs and their average apportionment factors.

Based on sample data (1998 base year), corporations whose primary operation is the manufacture of prescription drugs reported spending roughly \$7.2 billion for advertising. It was assumed that roughly two-thirds of each corporation's reported advertising expenses before apportionment was for advertising the sale, use, or consumption of prescription drugs. For each corporation represented in the sample data, targeted advertising expenses were multiplied by its average apportionment factor and the franchise tax rate of 8.84%. Unapplied credits were applied to any calculated additional tax. The result for each corporation was multiplied by its sample weight. Revenue gains at the 1998 level were grown to future years by the growth rate in corporate profits as projected by the Department of Finance.

## **POLICY CONCERNS**

The bill specifies that a manufacturer may not deduct amounts paid or incurred to advertise prescription drugs; however, it would not prevent other taxpayers that are not manufacturers or an affiliate of the manufacturer from deducting the costs of advertising the prescription drugs. Also, since this bill only impacts corporate manufacturers, it would not preclude other business entities such as sole proprietorships and partnerships from claiming a deduction for advertising the prescription drugs that they manufacture. The author may wish to use the term "taxpayer" rather than "manufacturer" to eliminate the potential loophole or simply state, "no deduction is allowed..." without referring to a particular entity.

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation that may lead to noncompliance.

## **LEGISLATIVE STAFF CONTACT**

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